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Remarks

Executive Secretary

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THE WHITE HOUSE

WASHINGTON

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February 3, 1986

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: EUGENE J. McALLISTER EM

SUBJECT: Agenda and Papers for the February 4 Meeting

The agenda and papers for the February 4 meeting of the Economic Policy Council are attached. The meeting is scheduled for 3:00 p.m. in the Roosevelt Room.

The first agenda item will be a discussion of Canada's policy of forced divestiture of foreign investments in certain "culturally sensitive" sectors. The TPRG has prepared a paper describing a possible "marker" the Administration might lay down with regard to the policy of forced divestiture. Ambassador Yeutter also will brief the Council on the latest developments in the Gulf and Western Corporation negotiations with the Canadian Government.

The second agenda item will be a discussion on the issues involved in a sectoral trade approach, particularly with regard to telecommunications. The TPRG has prepared a paper describing the issues raised by a sector trade approach, noting U.S. objectives, and outlining possible Administration responses. The paper is attached.

Confidential Attachments

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THE WHITE HOUSE

WASHINGTON

ECONOMIC POLICY COUNCIL

February 4, 1986

3:00 p.m.

Roosevelt Room

AGENDA

1. Canadian Forced Divestiture Policy
2. Sectoral Trade

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CONFIDENTIAL

January 31, 1986

CANADA: FORCED DIVESTITURE OF FOREIGN INVESTMENTS

Issue

(C) In July 1985, Canada adopted a restrictive and in some cases retroactive policy to limit new investments and to force divestiture to Canadians of existing foreign investments in book publishing and distribution. Similar policies are likely to follow for other "culturally-sensitive sectors" such as films. Divestiture policies also exist in the energy sector.

(C) The President, Secretaries Shultz, Baker, and Baldrige and Ambassador Yeutter have raised strong concerns with Canadian counterparts but these concerns have been focused thus far on the book publishing policy and the expected retroactive application of this policy in one specific case, Gulf and Western's takeover of Prentice Hall with a subsidiary in Canada.

(C) There has been no progress to date; some members of Congress are concerned about the implications of this issue for bilateral free trade negotiations, and may withhold negotiating authority. Canada may not decide the Gulf and Western case for at least the next several weeks.

(C) This paper seeks EPC approval for an immediate step to indicate our concern to Canada on their investment policies in culturally-sensitive industries and their impact on U.S.-Canada relations. It recommends that we lay down a "marker" with the Canadians which makes our position clear with respect to Canada's investment policy:

-- We reserve the right to respond with countermeasures;

-- We seek a standstill on implementation of the policy and its extension to new sectors; and

-- It is unacceptable to put restrictive measures in place and expect the United States to "pay" in negotiations.

(C) EPC should also decide whether we wish to include the Gulf and Western case as part of our marker. Ambassador Yeutter will brief the EPC on the latest developments in the Gulf and Western/GOC negotiations.

Classified by: S. Canner/OASIA/ITI
Declassify: January 29, 1992

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(C) The EPC should be aware that if our concerns about Canada's investment policies are not resolved satisfactorily by the time of Prime Minister Mulroney's visit, it is almost inevitable that forces will be brought to bear on the President to raise the issues with the Prime Minister.

Background: Canada's Investment Policies

(U) The recently-passed Investment Canada Act generally liberalized Canada's policy toward inward direct investment by exempting many new "start-up" foreign investments and smaller acquisitions from the screening procedure. However, the GOC retained the right to screen all proposed foreign investments in "culturally-sensitive" sectors.

(U) In July 1985, Canada announced a very restrictive policy for the first "culturally-sensitive" sector, book publishing and distribution. New "start-up" foreign investments in book publishing and distribution would be welcomed only in the form of Canadian-controlled joint ventures. Furthermore, Canada would permit acquisitions only if the foreign investor agreed to divest ownership and control to Canadian firms within a "reasonable period of time (e.g., two years)."

(LOU) The Canadian policy of forced divestiture clearly impedes and distorts investment flows, and runs counter to the President's September 1983 statement on international investment policy. Forcing divestiture to Canadians reduces the number of potential buyers and creates a forced sale permitting Canadians to purchase divested assets for less than what firms might be willing to pay the seller.

Gulf and Western Case

(C) Gulf and Western's acquisition of Prentice Hall in the United States in December 1984, included a Prentice Hall subsidiary in Canada. This transaction in the United States represented an "indirect" acquisition in Canada, which did not increase the level of foreign investment. Under the new, and in this case retroactive, policy, the GOC may decide in the near future to force Gulf and Western to divest control within two years via a joint venture or a complete sell-off of the Canadian subsidiary. Gulf and Western recently has made an offer to extend 20 percent ownership to Canadians, and to establish a fund to promote Canadian authors in the United States.

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(C) The Gulf and Western case has become a cause celebre for economic nationalists in Canada, and Mulroney feels that he must demonstrate that he can protect Canada's "cultural sovereignty." Other, smaller publishing investments made prior to the July 1985 policy also are pending approval in Canada.

While we do not have data on foreign investment on book publishing per se, figures are available on foreign investment in printing and publishing (which includes the newspaper industry). For this broader sector, Canadian investment in the United States is larger and growing more quickly than U.S. investment in Canada. Canadian investment in the U.S. sector increased between 1977 and 1983 from $774 million to $2.1 billion, while U.S. investment in the Canadian sector only rose from $226 million to $278 million.

Other Sectors

(LOU) In addition to book publishing, Canada has pursued for several years a forced divestiture policy for foreign investments in the oil and gas sector.

(C) Thus far, book publishing is one of several sectors defined as culturally-sensitive by the Canadians; it is the only one to date for which a specific policy has been announced. We understand that pressure to expand the policy to new areas is building, in particular the film industry. Such extensions might be packaged in the context of a decision favorable to Gulf and Western, to soften the domestic reception in Canada. Such an action would complicate our Congressional process necessary to begin the free trade negotiations, but once in place could be used by Canada as bargaining chips in these negotiations.

Recommendation

(C) We should take action now to "put down a marker" which makes our position clear with respect to Canada's investment policies, and in particular, the possible extension of the culturally-sensitive industry policy.

(C) Key points, to be delivered privately, are as follows:

(A) Recall our concerns on Gulf and Western case but emphasize that issues for USG are separate and distinct from those embodied in Gulf and Western's negotiations with the GOC.

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(B) These broader issues involve Canadian investment laws and policies adversely affecting U.S. interests, adding another element of friction to bilateral relations; could significantly complicate free trade negotiations.

(C) Emphasize forced divestiture, and possibility of extension to new sectors, e.g., films.

(D) Congress could tie our hands in free trade negotiations.

(E)* Unacceptable for one side to put restrictive investment measures in place and expect other side to "pay" in negotiations; same holds true for new trade restrictive measures.

(F)* We reserve the right to respond with appropriate countermeasures.

(G)* Seek commitment to standstill on implementation of investment policy, and on extending investment laws to new sectors.

(* These three points are main operative parts of the "marker.")

Options for Gulf and Western

(C) At this stage it is premature for the EPC to decide on courses of action if our efforts fail. Interagency staff is considering a number of possibilities to include: jawboning, monitoring Canadian investment in the United States by the Committee on Foreign Investment in the United States (CFIUS), mirror legislation for future forced divestiture of Canadian takeovers in the U.S. book publishing sector, action under section 301 of the Trade Act, and other possibilities.

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SECTORAL TRADE

ISSUE

The Trade Policy Review Group has developed for consideration by the Economic Policy Council several proposed policies concerning telecommunications trade. The Council needs to develop a policy because telecommunications trade legislation may soon be considered in the Congress.

STATUS AND DESCRIPTION OF LEGISLATION

In December, the Senate Finance Committee unanimously approved the Danforth telecommunications trade bill, which is now pending on the Senate calendar. It appears there is substantial momentum behind the bill, which could reach the floor shortly.

In November, the House Energy and Commerce Committee unanimously approved the Wirth/Florio telecommunications trade bill, which is similar to, but more restrictive than, the Danforth bill. Congressman Matsui has proposed a bill that is somewhat less restrictive than either the Danforth or Wirth/Florio bills.

In general, these legislative proposals would require retaliation against countries which do not grant market access for telecommunications products similar to that which they enjoy in the U.S. In particular, the Danforth bill would include two tracks:

1. It would require USTR within 4½ months of enactment to retaliate against countries maintaining telecommunications trade barriers that violate or otherwise deny U.S. benefits under any trade agreement.

2. It would require the President within 18 months of enactment to submit a bill for "fast-track" approval which would achieve sectoral reciprocity in telecommunications trade with each major potential market, through a combination of U.S. retaliatory restrictions, trade agreements opening foreign markets, and reduced U.S. barriers in telecommunications or other sectors to "pay" for foreign concessions and compensate for U.S. retaliation.

The Administration opposes the first track because it would mandate retaliation by USTR on a fixed schedule, while Section 301 only authorizes the President to retaliate as and when he deems appropriate. The Administration opposes the second track because it mandates the unworkable standard of substantially equivalent competitive opportunity (SECO), or sectoral reciprocity, with each country and requires the President to submit a bill achieving that objective. The President could veto that bill, albeit at some cost.

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In September 1985, the Council approved the following set of principles to which the Administration could agree in telecommunications trade legislation:

> The Administration can support legislation on telecommunications that would require us to identify obstacles to fair and equitable market opportunities abroad for U.S. telecommunications equipment and services, and to seek, through negotiations, removal of those obstacles; and authorize the President to take all appropriate measures (including retaliation) to attain such fair and equitable market opportunities. Where the President negotiated an agreement or decided to retaliate, he would be authorized to send a bill to the Congress for "fast track" approval of any such agreement or compensation the President believed as required.

The Administration has heretofore neither taken a formal position on the Danforth and House bills nor attempted to negotiate with the bills' sponsors on specific elements of the bills. However, the Administration has indirectly communicated the above principles to various members of Congress.

POTENTIAL POLICY MODIFICATIONS

Modifications that the Administration might seek in the Danforth bill include:

- o Changing the SECO requirement to an objective of "fair and equitable market opportunities" or alternatively, making the SECO standard an objective, instead of making it mandatory.

- o Removing the time deadlines both for retaliation and for submission of implementing legislation for fast-track approval. Combined with the above change, this provision would: (a) enable the Administration to submit useful, if modest, agreements as we succeeded in negotiations; and (b) obviate the need ever to submit retaliation legislation. The Administration could propose a requirement for regular consultations with the Congress as a harmless substitute for the current deadlines for action.

- o Eliminating the provisions for mandatory retaliation by USTR for denial of U.S. rights under trade agreements, leaving these issues to existing Section 301 authority.

OBJECTIVES

The Administration has the following objectives in this issue:

- o We should maximize our leverage in negotiations with countries to open their telecommunications markets. Pending legislation, even if it includes provisions the Administration

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would find unacceptable, could enhance our leverage in any discussions with European countries and Canada and encourage full Japanese implementation of their market-opening measures.

- We should seek to maintain presidential discretion both in deciding how and when to retaliate against unfair foreign trade practices and in deciding negotiating priorities.

- We should seek to avoid sectoral approaches to trade legislation and negotiations because they tend to pit one U.S. industry against other U.S. industries. To the extent that sectoral approaches lead to retaliation/compensation, they force other U.S. industries to "pay" for benefits to the sector on which the legislation focuses.

- We should avoid mandating sectoral reciprocity (SECO) with each country because it appears that it would not achieve trade liberalization since cross-sectoral trade-offs are essentially.

OPTIONS

The TPRG has developed the following options for Council consideration:

Option 1: Continue to express no position, hoping that industry concerns and differences among the various bills will mean no bill will pass.

Advantages

- This approach may result in legislation remaining in a pending status, which could enhance our leverage in efforts to open foreign telecommunications markets.

- This approach would avoid a direct and perhaps unnecessary confrontation with the Congress.

Disadvantages

- The Administration could appear too equivocal or indifferent on an important issue.

- This approach could result in a troublesome or unacceptable bill arriving on the President's desk.

- Continuing official silence could further annoy key congressional leaders.

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Option 2: Clearly oppose all telecommunications trade legislation, and explain to the sponsors that the modifications we would seek would vitiate the legislation and that the legislation would be more effective in enhancing our leverage by remaining in a pending status.

Advantages

- o This approach would avoid misleading the Congress that the Administration would accept any legislation on this issue.
- o This approach is consistent with Administration opposition to sectoral approaches.

Disadvantages

- o Opposing such legislation could reduce our leverage in efforts to open foreign telecommunications markets.
- o This approach could reduce our ability to shape legislation if the Congress proceeds with legislation in any case.
- o Clearly opposing legislation could annoy key congressional leaders and the industry more than official silence.

Option 3: Seek modifications in the legislation as discussed earlier (changing the SECO requirement, removing the time deadlines for retaliation, and eliminating mandatory retaliation by USTR).

Advantages

- o This approach is more likely than option 1 (continue to express no position) to achieve legislation the Administration could find acceptable.
- o If the resulting legislation were appropriate, it may enhance our leverage in efforts to open foreign telecommunications markets.

Disadvantages

- o This approach would establish a precedent for supporting sectoral legislation.
- o Assisting the telecommunications industry separately may remove its incentive to support general trade negotiating authority.

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